

October 30, 2001

The Honorable James S. Gilmore, III
Governor of Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission

Commission Members
The Tobacco Indemnification
and Community Revitalization Commission

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING

In planning and performing our audit of the financial statements of the Tobacco Indemnification and Community Revitalization Commission as of and for the year ended June 30, 2001, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, contracts, and grants in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards.

Compliance

As part of obtaining reasonable assurance about whether the Tobacco Indemnification and Community Revitalization Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Tobacco Indemnification and Community Revitalization Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance

on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Tobacco Indemnification and Community Revitalization Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition, entitled "Continue to Improve Operations" is described in the section titled "Internal Control Findings and Recommendations."

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Status of Prior Findings

The Tobacco Indemnification and Community Revitalization Commission has taken adequate corrective action with respect to audit findings reported in the prior year.

The "Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting" is intended solely for the information and use of the Governor and General Assembly of Virginia, the Tobacco Indemnification and Community Revitalization Commission's members and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on December 12, 2001.

AUDITOR OF PUBLIC ACCOUNTS

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INTERNAL CONTROL FINDINGS AND RECOMMENDATION

Continue to Improve Financial Operations

The Tobacco Indemnification and Community Revitalization Commission should ensure that it completes its contractual negotiations with agencies and vendors in a timely manner and includes all requirements necessary to provide assurance of internal control.

- The Commission did not finalize its Memorandum of Understanding (MOU) with its fiscal agent, the Virginia Department of Agriculture and Consumer Services (Agriculture), until January 16, 2001 for fiscal year 2001 and October 2001 for fiscal year 2002.
- The Commission entered into a contract with a private law firm to develop and maintain a database to process indemnification payments to tobacco farmers. This database maintains the payment data for approximately \$100 million issued to farmers in the past two years. However, the contract does not require a SAS 70 review to determine that the law firm has adequate internal controls over processing controls or has restricted the logical and physical access to data.
- The law firm transmits indemnification data to Agriculture for a preliminary review and uploads to their financial system. Agriculture then transmits this data to the Department of Accounts (DOA) for payment processing. While there are adequate procedures to ensure that Agriculture accurately receives database data, no procedures exist to ensure that Agriculture transmits the same data to DOA for payment.

We recommend that the Commission continue to improve its financial operations, ensuring that it completes its contractual negotiations in a timely manner. Further, contracts should include provisions to have reviews conducted by outside parties to ensure service organizations properly control and maintain data. Finally, we recommend that the Commission develop procedures to ensure that it reconciles the original database information to the actual payments.